



THE NATION'S  
**GROWING**  
Fiscal Imbalance

The Honorable David M. Walker  
Comptroller General of the United States

CSIS Global Aging Forum  
June 16, 2004

# GAO's Strategic Plan



## SERVING THE CONGRESS AND THE NATION GAO'S STRATEGIC PLAN FRAMEWORK

### MISSION

GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.

### THEMES

- Long-Term Fiscal Imbalance
- National Security
- Global Interdependence
- Changing Economy
- Demographics
- Science and Technology
- Quality of Life
- Governance

### GOALS & OBJECTIVES

Provide Timely, Quality Service to the Congress and the Federal Government to ...

Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People *related to . . .*

- Health care needs and financing
- Education and protection of children
- Work opportunities and worker protection
- Retirement income security
- Effective system of justice
- Viable communities
- Natural resources use and environmental protection
- Physical infrastructure

Respond to Changing Security Threats and the Challenges of Global Interdependence *involving . . .*

- Emerging threats
- Military capabilities and readiness
- Advancement of U.S. interests
- Global market forces

Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges *by assessing . . .*

- Roles in achieving federal objectives
- Government transformation
- Key management challenges and program risks
- Fiscal position and financing of the government

Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization *in the areas of . . .*

- Client and customer satisfaction
- Strategic leadership
- Institutional knowledge and experience
- Process improvement
- Employer of choice

### CORE VALUES

Accountability

Integrity

Reliability

# GAO's High Risk List

## High Risk Areas

## Designated High Risk

### Addressing Challenges in Broad-based Transformations

Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs*	2003
Federal Real Property*	2003

### Ensuring Major Technology Investments Improve Services

FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995

### Providing Basic Financial Accountability

DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999

### Reducing Inordinate Program Risks

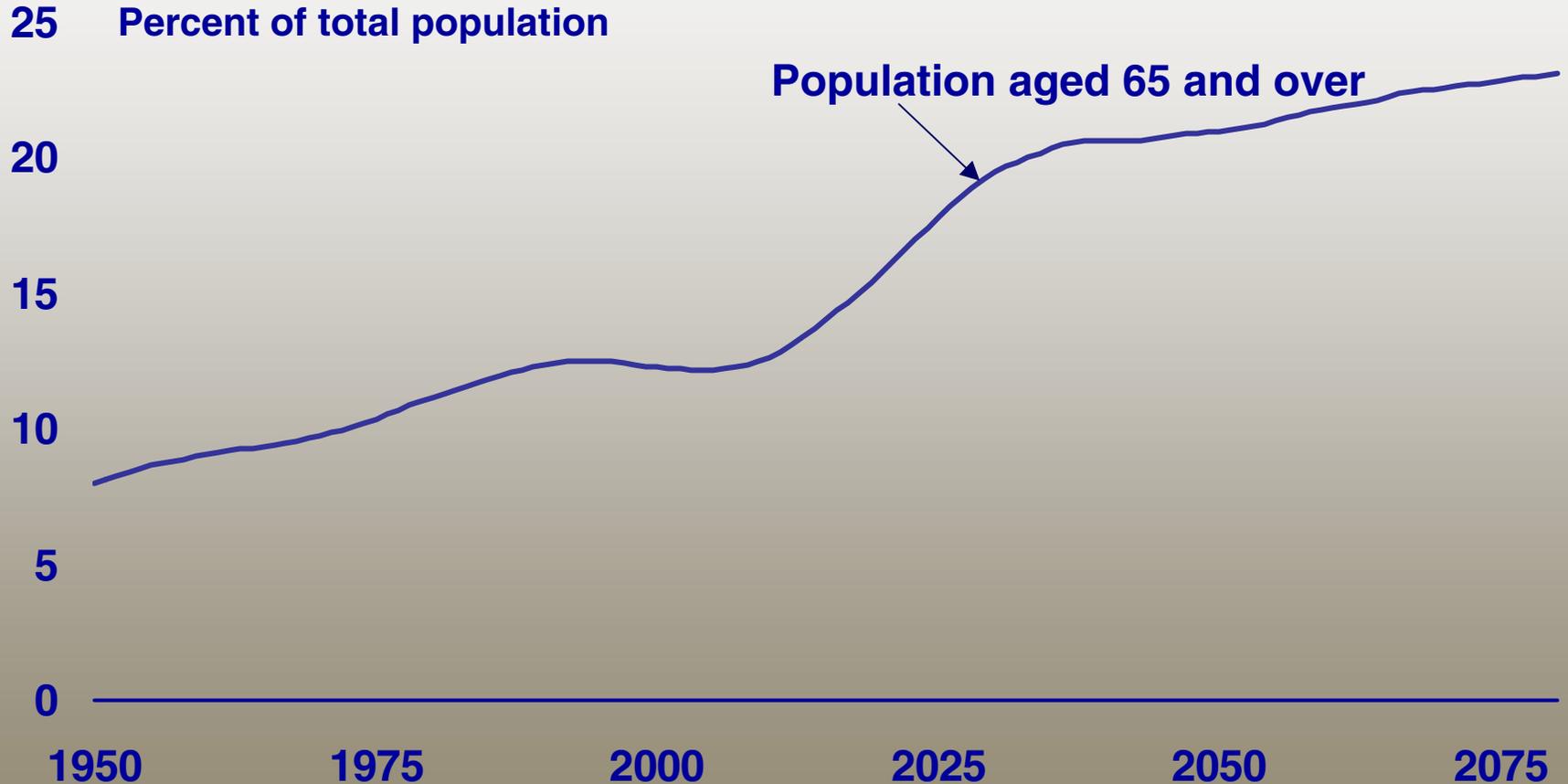
Medicare Program*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program*	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program*	2003

### Managing Large Procurement Operations More Efficiently

DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

\*Additional authorizing legislation is likely to be required as one element of addressing this high risk area.

# Aged Population as a Share of Total U.S. Population Continues to Grow

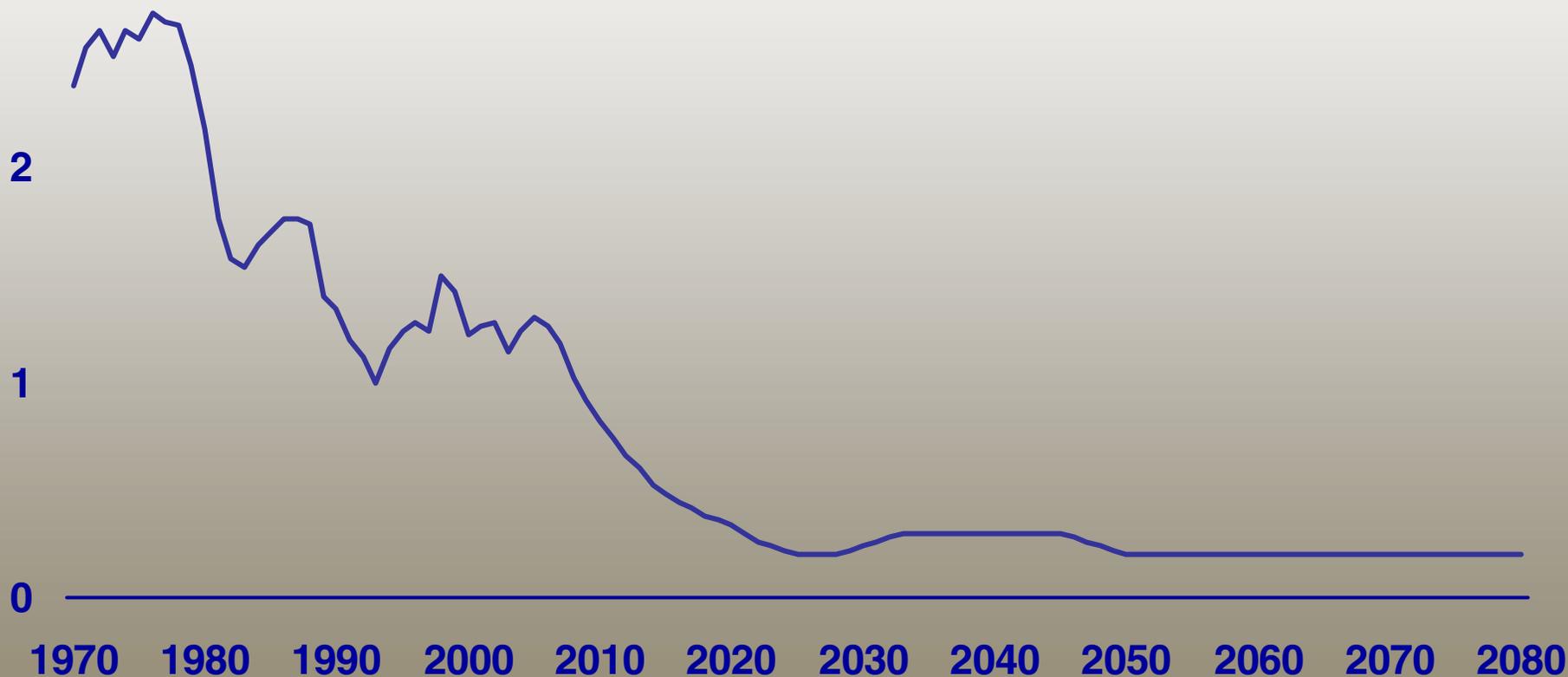


Note: Projections based on the intermediate assumptions of the 2004 Trustees' Reports.

Source: Office of the Chief Actuary, Social Security Administration.

# Labor Force Growth is Expected to be Negligible by 2050

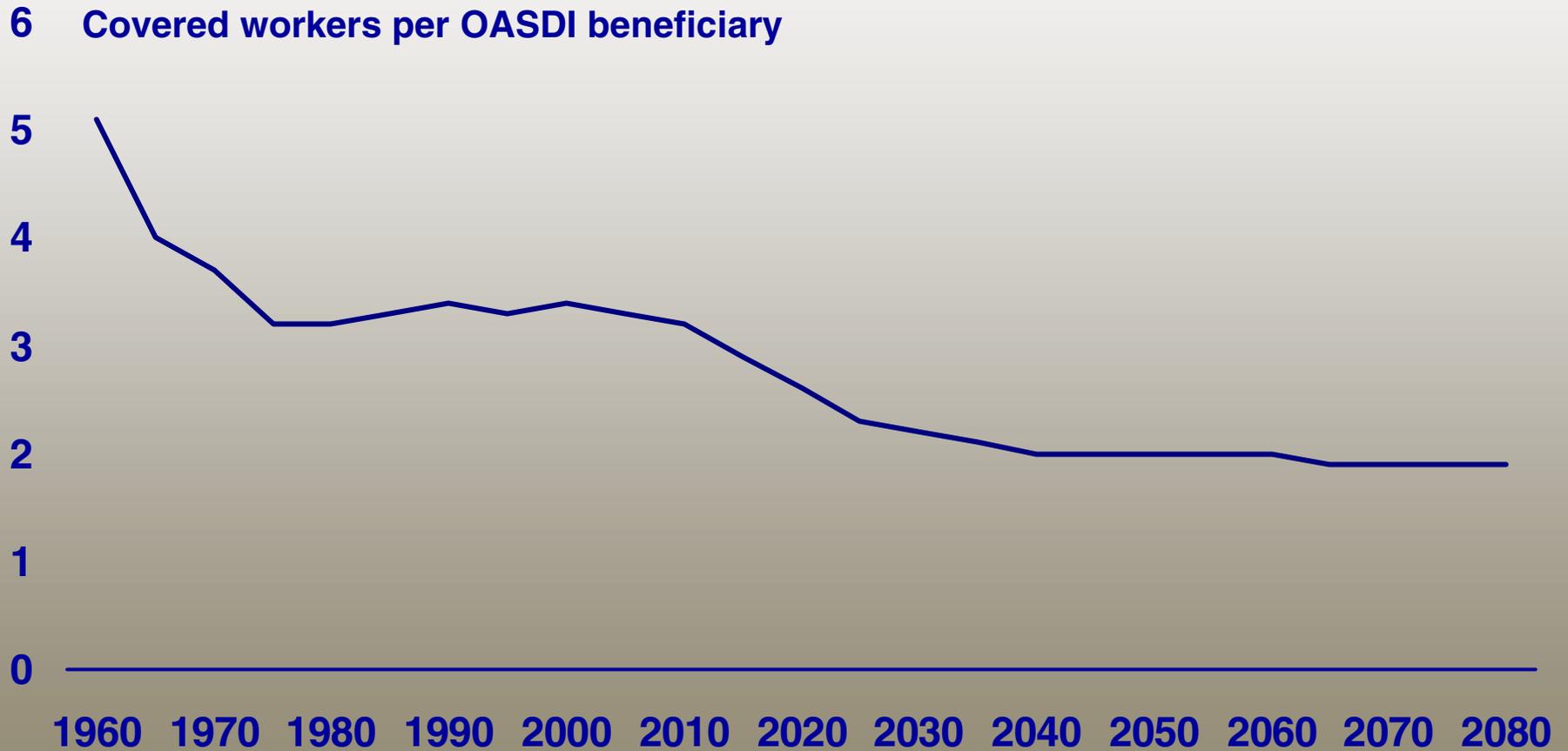
3 Percentage change (5-yr moving average)



Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2004 Trustees Reports.

Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

# Social Security Workers per Beneficiary

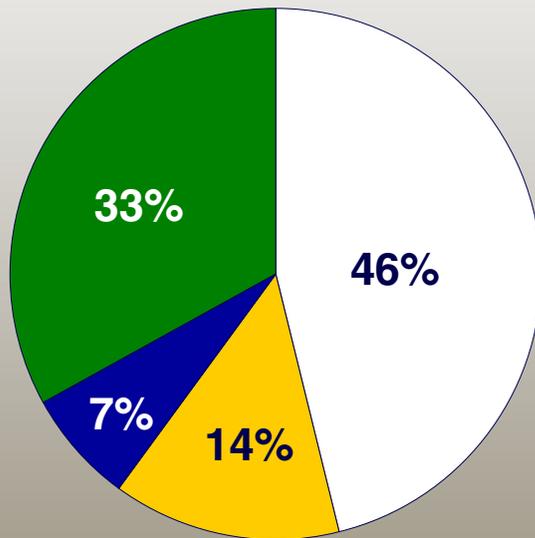


Note: Projections based on the intermediate assumptions of the 2004 Trustees' Reports.

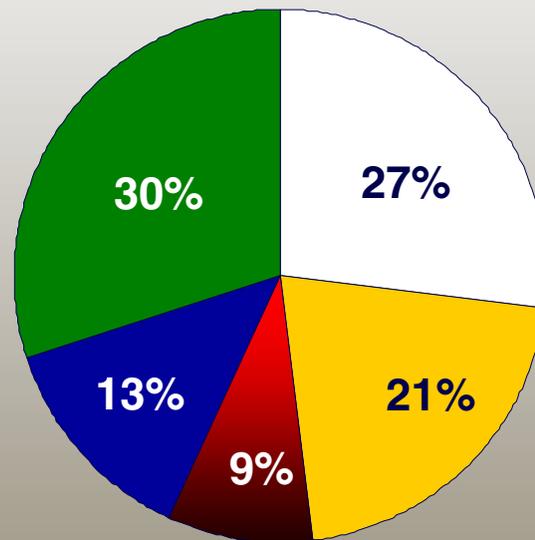
Source: Office of the Chief Actuary, Social Security Administration.

# Composition of Federal Spending

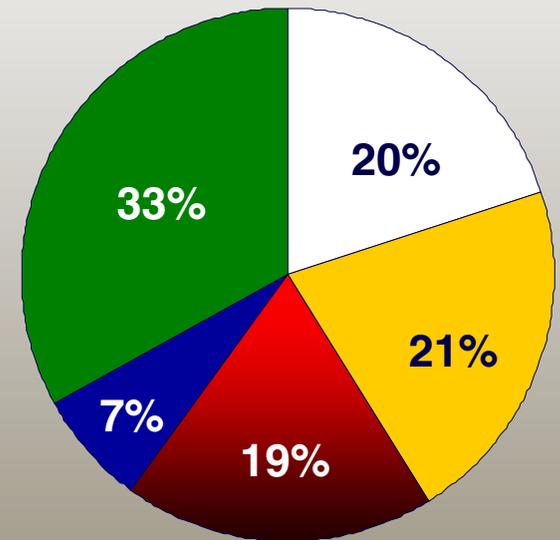
1964



1984



2004\*



Defense  
Net interest

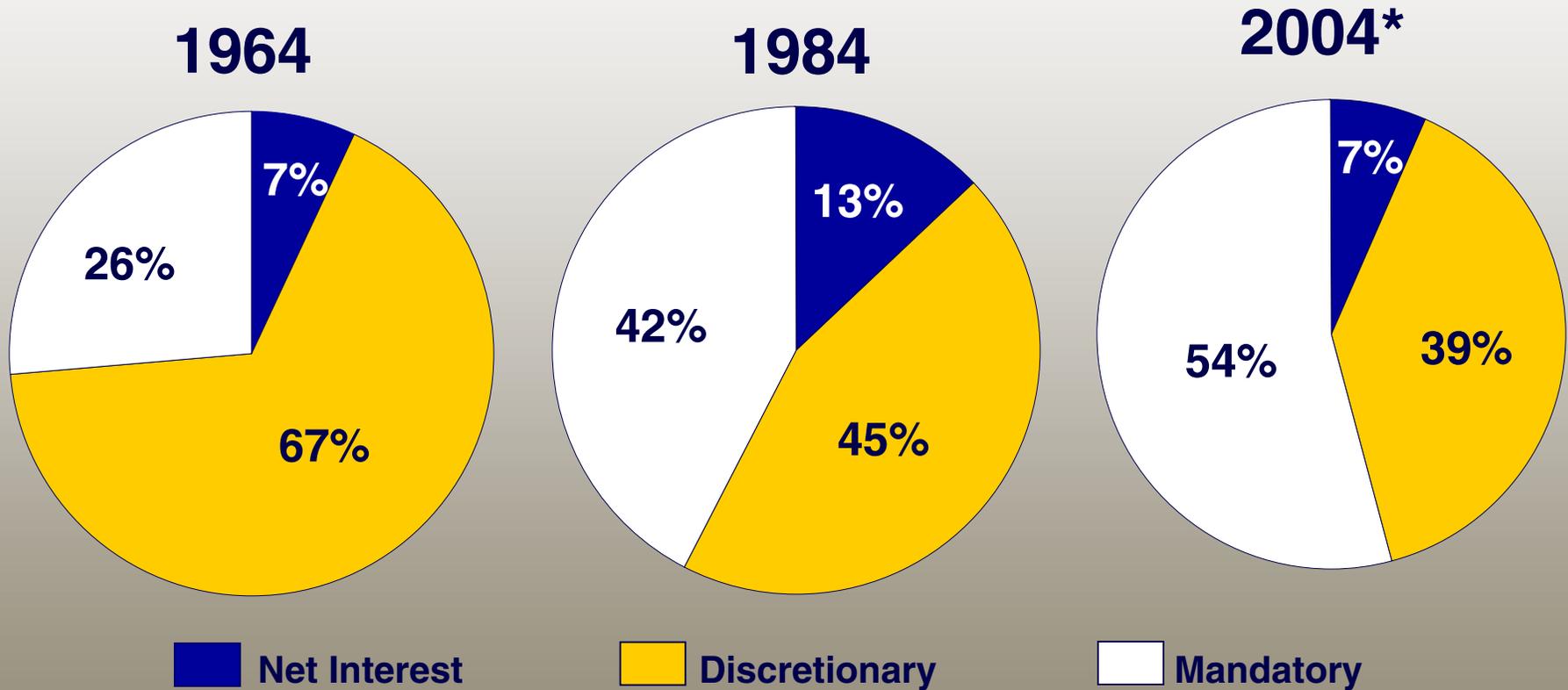
Social Security  
All other spending

Medicare & Medicaid

\*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

# Federal Spending for Mandatory and Discretionary Programs



\*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

# Selected Fiscal Exposures: Sources and Examples (End of 2003)<sup>a</sup>

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt (\$3,913) Military and civilian pension and post-retirement health (\$2,857) Veterans benefits payable (\$955) Environmental and disposal liabilities (\$250) Loan guarantees (\$35)
Explicit financial commitments	Undelivered orders (\$596) Long-term leases (\$47)
Explicit financial contingencies	Unadjudicated claims (\$9) Pension Benefit Guaranty Corporation (\$86) Other national insurance programs (\$7) Government corporations e.g., Ginnie Mae
Implicit exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$2,859) <sup>b</sup> Future Social Security benefit payments (\$3,699) <sup>c</sup> Future Medicare Part A benefit payments (\$8,236) <sup>c</sup> Future Medicare Part B benefit payments (\$11,416) <sup>c</sup> Future Medicare Part D benefit payments (\$8,119) <sup>c</sup> Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

<sup>a</sup> All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

<sup>b</sup> This amount includes \$774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

<sup>c</sup> Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Updated 3/30/04.

# Another Way to Think About These Numbers

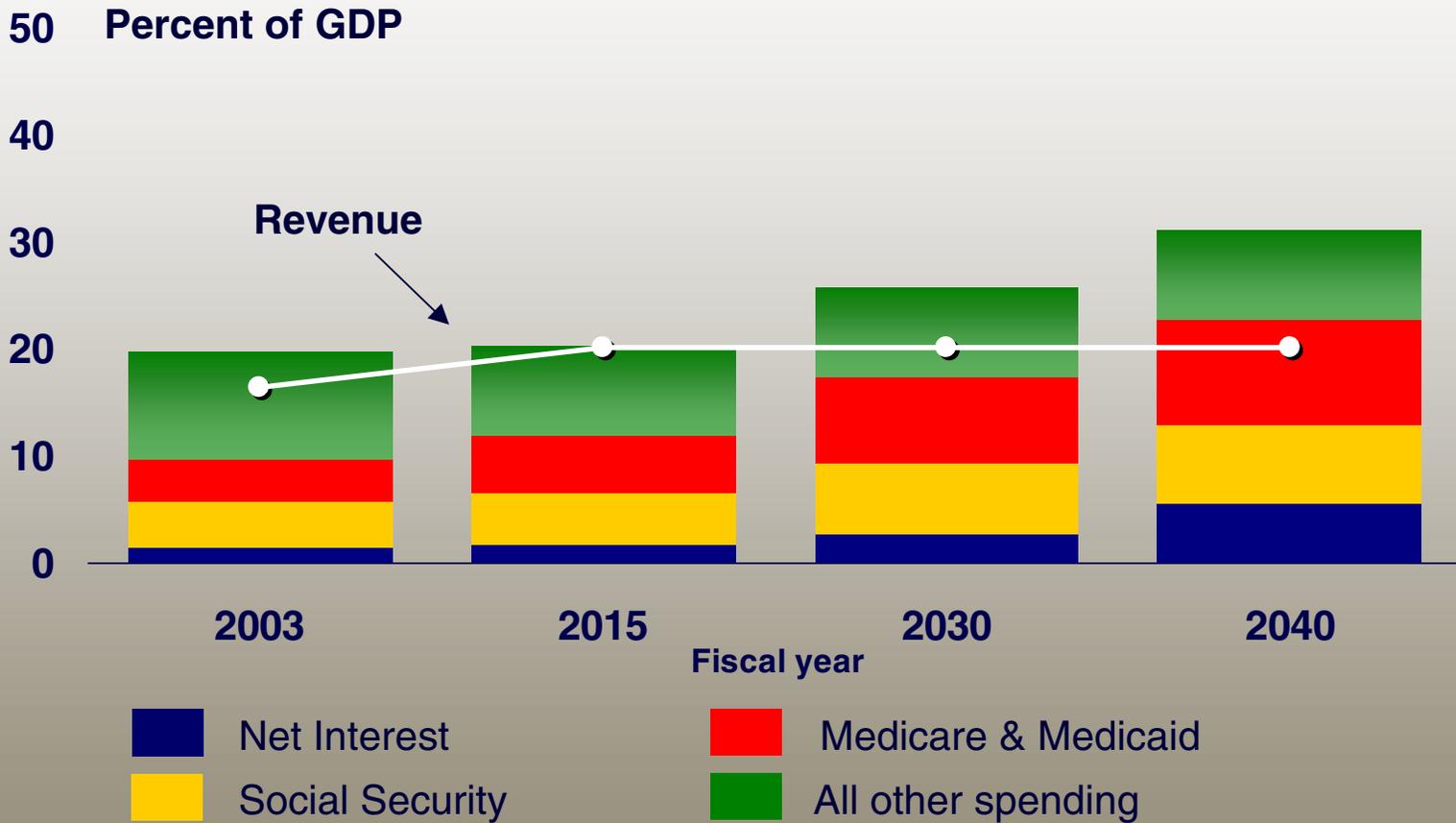
## As of the End of FY 03

- Debt held by the public—\$3.9T
- Trust fund debt—\$2.9T
- Gross debt—\$6.8T
- Gross debt per person—about \$24,000
- If we add everything on the previous slide that is not included in gross debt, the burden per person rises to over \$140,000. Alternatively, it amounts to a total unfunded burden of more than \$40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

# Composition of Spending as a Share of GDP

## Under Baseline Extended

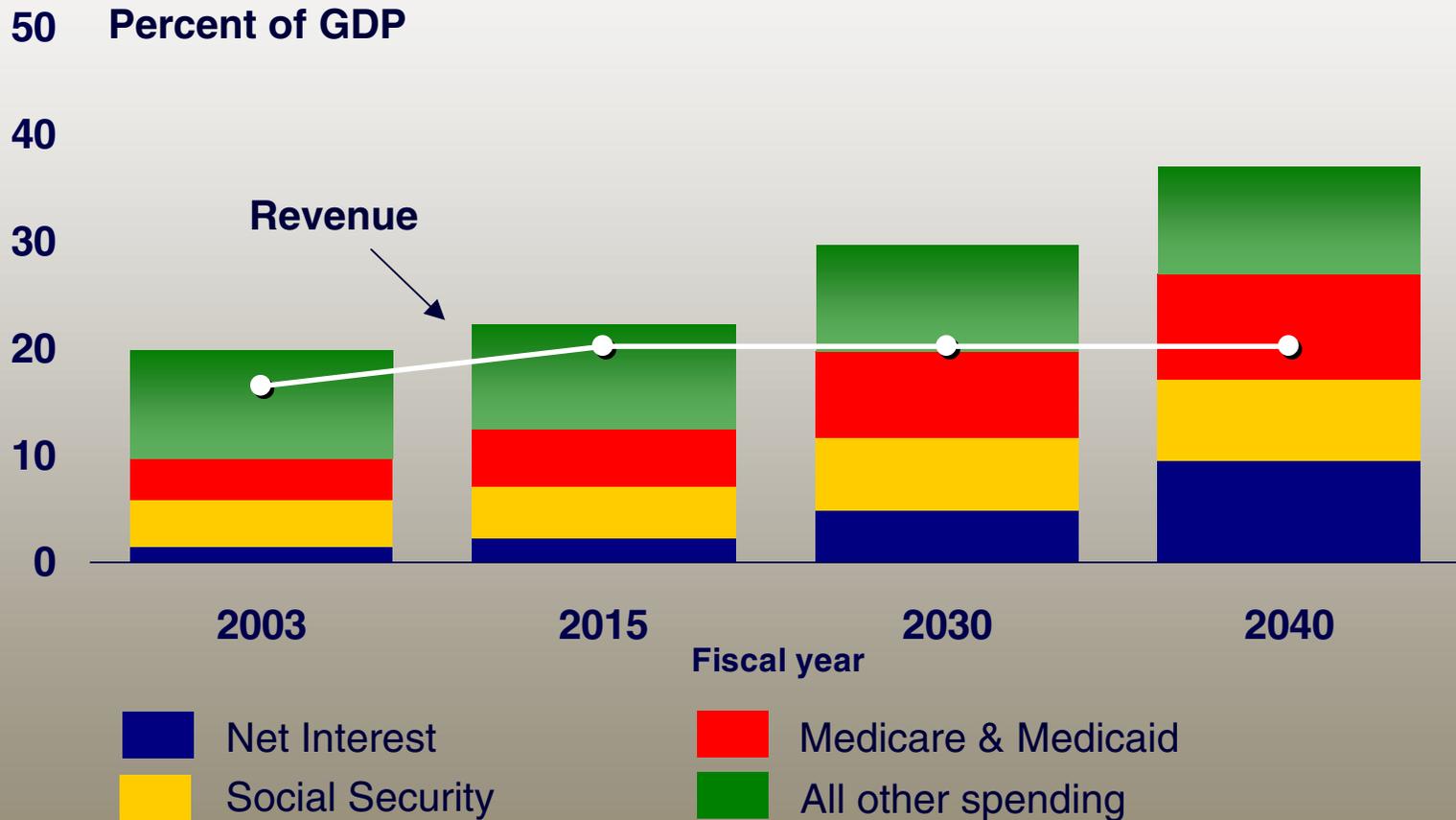


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2004

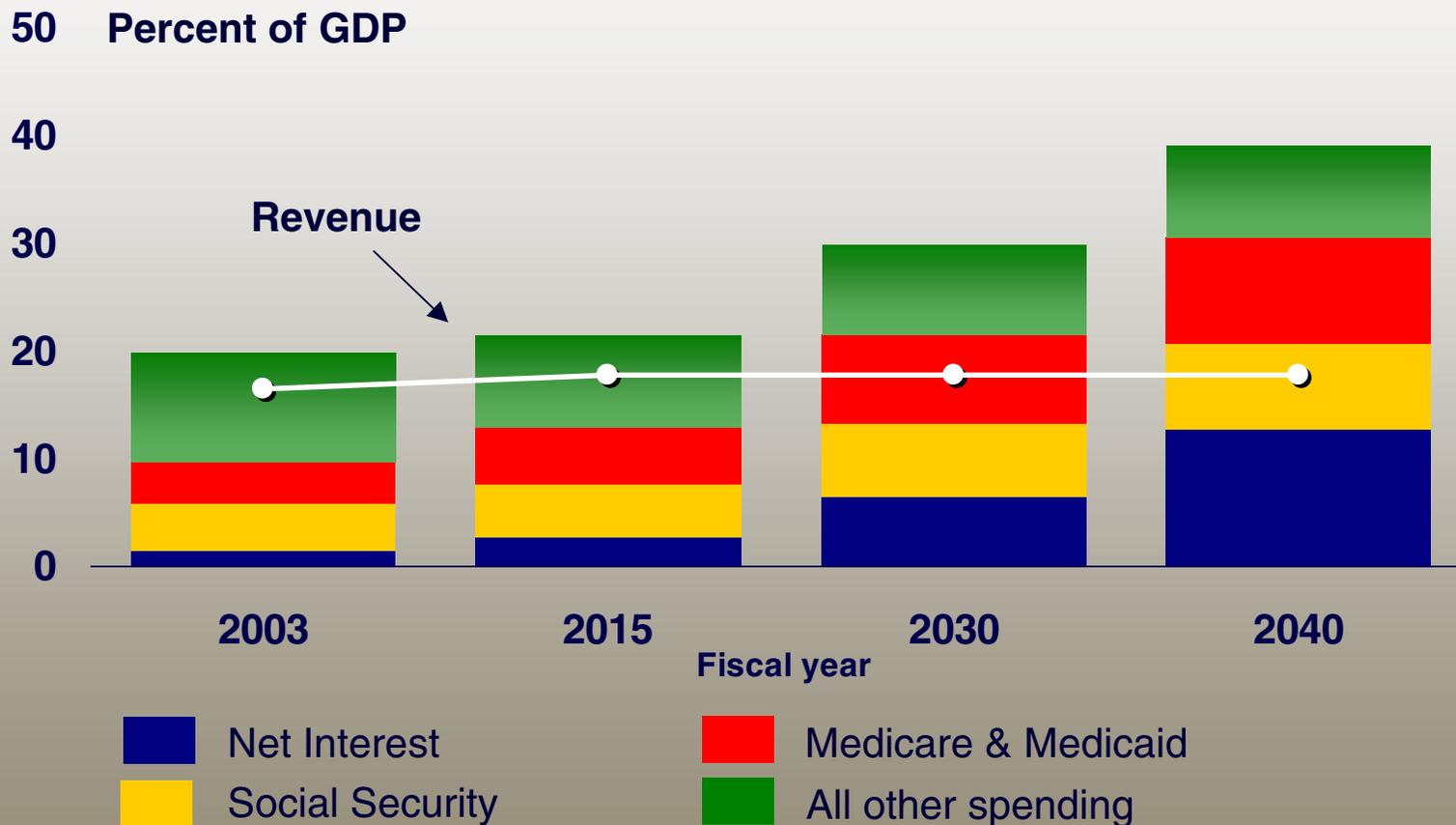


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Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

Assuming All Expiring Tax Provisions are Extended

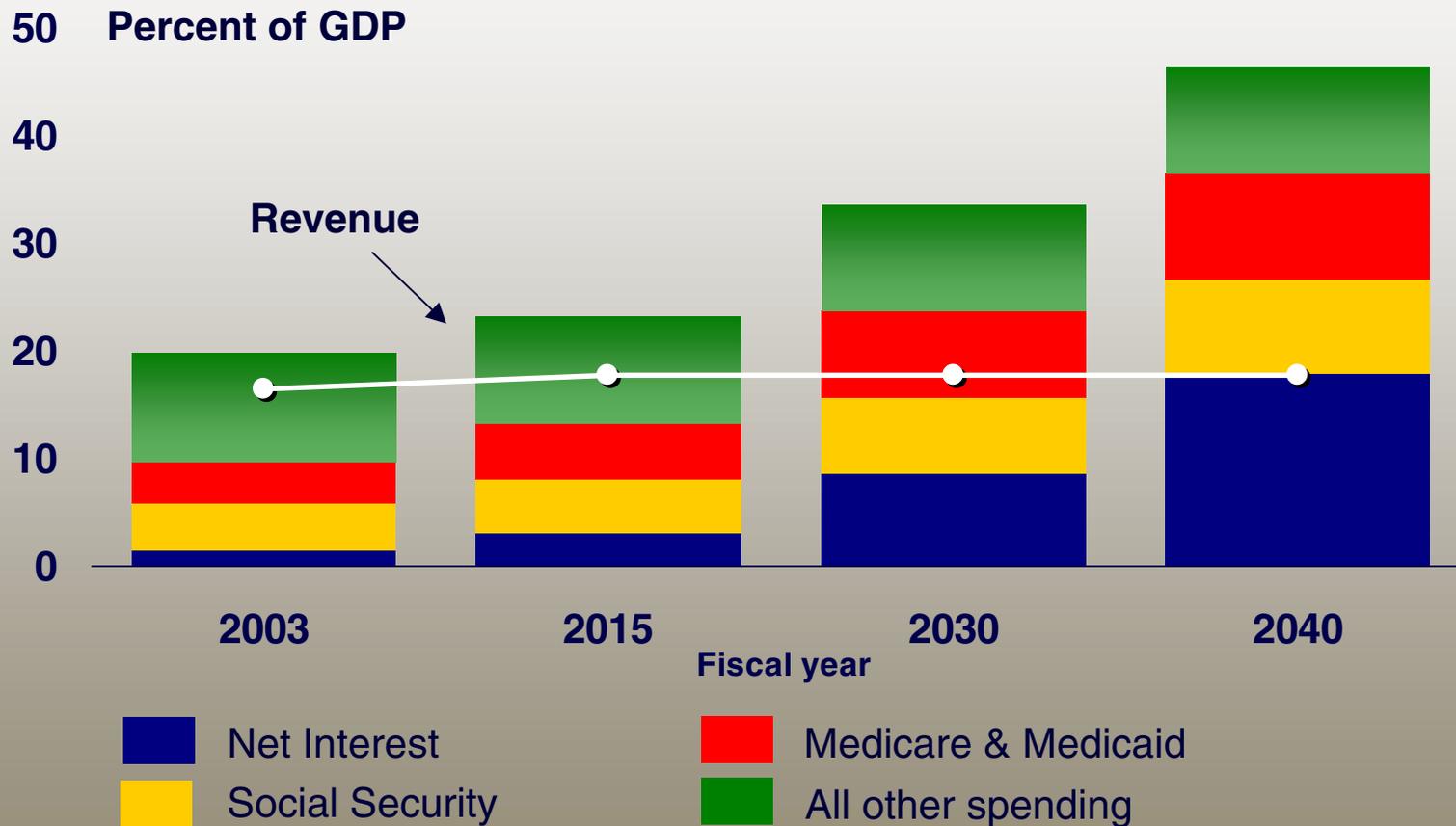


Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

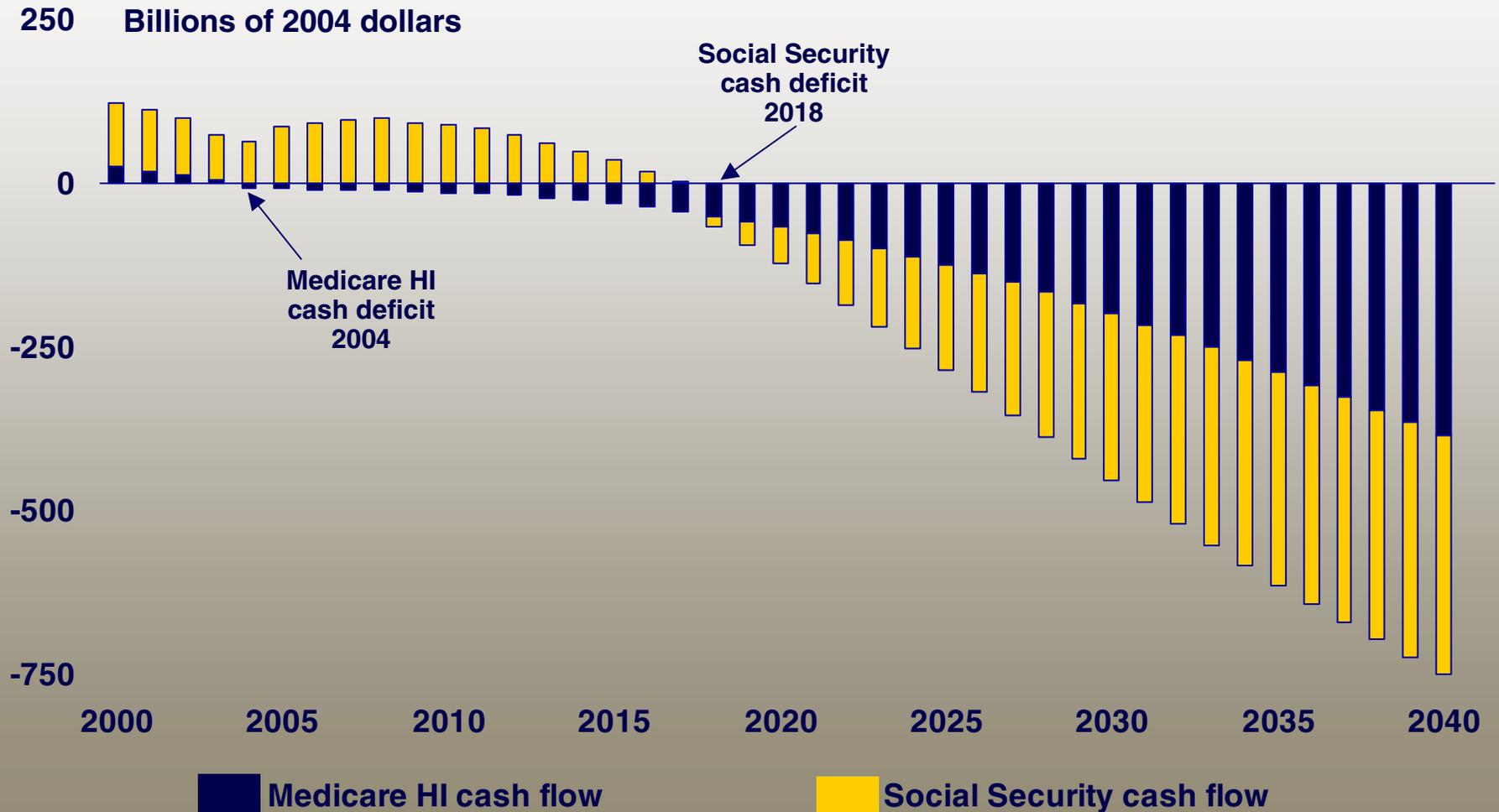
Assuming Discretionary Spending Grows with GDP After 2004 and All Expiring Tax Provisions Are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

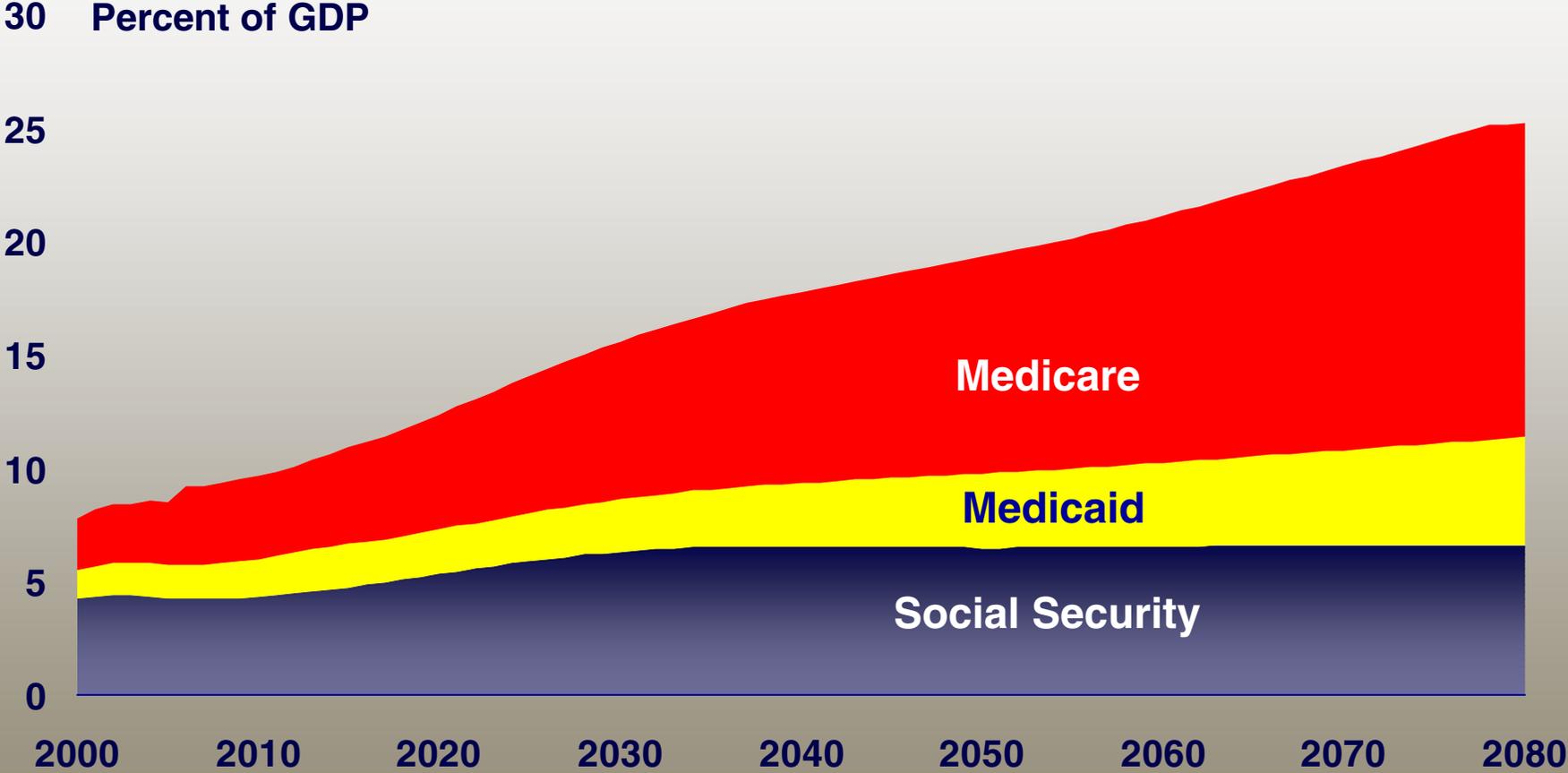
Source: GAO's March 2004 analysis.

# Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



Source: GAO analysis based on the intermediate assumptions of *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* and *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. The above excludes Medicare Part B and the newly enacted Medicare Part D benefit.

# Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

# Current Fiscal Policy Is Unsustainable

- **The “Status Quo” is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
  - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
    - Cutting total federal spending by about 60 percent or
    - Raising taxes to about 2.5 times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at on average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
  - Less change would be needed, and there would be more time to make adjustments.
  - The miracle of compounding would work with us rather than against us.
  - Our demographic changes will serve to make reform more difficult over time.

# The Way Forward

- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)
- Reexamine the base—question existing programs, policies and activities

# Long-term Fiscal Challenges Demand New Metrics, Mechanisms, & Processes

- Accounting and reporting policies for trust funds, Social Security, Medicare, Veterans benefits, among other things, need to be reviewed and revised.
- The current budget time horizon [2-year, 5-year, 10-year] does not capture many long-term costs—e.g. Social Security, Medicare, pension insurance—and other major tax and spending provisions
- Cash and obligations-based budgeting is misleading for insurance and some benefit programs
- Budget controls have expired—and we need to go beyond “holding the line” to “changing the base” in spending and tax policies

# Improved Metrics, Measures & Processes: Some Ideas

- Provide information on long-term costs of major spending and tax proposals before they are voted on, including showing long-term costs even for proposals that sunset
- Establish an OMB annual report on fiscal exposures, including appropriate measures and how to address them
- Consider fiscal targets, triggers, and points of order with focus on limiting growth of long-term commitments
- Move to accrual budgeting for employee pension, retiree health; disclose “risk assumed” [missing premium] for insurance
- Reinstitute budget controls (caps & PAYGO)

# We Need a 3-Pronged Approach

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

# GAO Criteria for Evaluating Social Security Reform Proposals

Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects.

Comprehensive proposals can be evaluated against three basic criteria:

- Financing sustainable solvency
- Balancing adequacy and equity in the benefits structure
- Implementing and administering reforms

# Evaluating Health Care System Reforms

- Cost, access, and quality challenges—together with obstacles to achieving efficiency—argue for fundamental system reform.
- A comprehensive review and reassessment of the overall health care system raises the following questions:
  - **What** are societal needs versus individual wants in our health care system?
  - **Who**—among individuals, employers, and governments—should be responsible for paying for health care?
  - **Where** can we find our most acute access, cost, and quality challenges? (e.g., What regions show patterns of underuse or overuse of medical services?)
  - **How** much of health care costs can government, employers, and individuals afford and sustain over time?
  - **When** are we going to get started, as the challenge gets bigger everyday and any delay compounds the problems?

# Framework for Evaluating Health Care System Reforms: **Cost**

## Does the proposal help to ensure:

- sustainable growth in public and private sector health care expenditures? e.g.,
  - are Medicare and Medicaid reform efforts aligned with the nation's long-term fiscal outlook?
  - are health care financing policies compatible with the efforts of U.S. companies to compete in global markets?
- efficient production and consumption of health care resources, including
  - economical pricing of services?
  - incentives for providers to make prudent medical decisions based on benefit and cost?
  - consumer sensitivity to the benefits and costs of health care services?
- that government tax incentives do not have unintended consequences?
- that government financing meets the nation's most critical health care needs?

# Framework for Evaluating Health Care System Reforms: **Access**

**Does the proposal help to ensure:**

- guaranteed access to essential health care coverage, including
  - catastrophic loss protection?
  - children's preventive health care services?
- an insurance market that adequately pools risk and offers alternative levels of coverage?

# Framework for Evaluating Health Care System Reforms: **Quality**

**Does the proposal help to ensure:**

- care that meets acceptable standards, including
  - lowering the occurrence of medical errors?
  - medical practices based on scientific evidence?
  - limiting disparities in treatment for all patients?

# Framework for Evaluating Health Care System Reforms: **Implementation**

## Does the proposal help to ensure:

- the development of an information infrastructure that provides prompt and reliable data to monitor cost, quality, and system integrity?
- transition to a new structure that effectively mitigates potential disruptions and any new demands on resources and affected individuals?
- oversight and enforcement mechanisms for effective accountability?
- reforms that consumers can easily adapt to and understand?

# Illustrative 21<sup>st</sup> Century Questions

- How should Social Security be reformed to make it both solvent and sustainable while better aligning it with 21<sup>st</sup> Century economic, demographic and fiscal realities?
- Should the current criteria and process for determining disability be revised in light of substantial changes in health care and real enhancements in work prospects for many who are disabled?
- What changes should be made to existing pension laws in order to enhance the retirement income security of workers and help assure the financial integrity of the PBGC?
- How should federal programs and policies be revised to encourage people to work longer and to facilitate phased retirement approaches?

# Illustrative 21<sup>st</sup> Century Questions

- How should our overall health care system be reformed to make it more successful and sustainable over time (e.g., focusing on certain defined needs versus unlimited wants; addressing the division of responsibilities between levels of government, employers, and individuals; and facilitating individual choice, cost control and quality improvement?)
- Which tax incentives and preferences need to be reconsidered given their cost and effects, failure to achieve goals intended by Congress, or their unintended consequences? For example, can adequate health care coverage be achieved at less cost and greater distributional equity through a fundamental redesign of the current health tax preferences, or through their elimination and the use of other means to provide for coverage?

# Illustrative Generic Re-examination Questions

- Is the program, policy, function or activity a direct result of specific legislation?
- Is the current mission fully consistent with the initial or updated statutory mission (e.g., no significant mission creep or morphing)?
- Does it relate to an issue of nationwide interest? If so, is a federal role warranted based on the likely failure of private markets or state and local governments to address the underlying problem or concern? Does it encourage or discourage these other sectors from investing their own resources to address the problem?
- Have there been significant changes in the country or the world that relate to the reason for initiating it?

# Illustrative Generic Re-examination Questions

- If the answer to the last question is yes, should the activity be changed or terminated, and if so, how? If the answer is unclear as to whether changes make it no longer necessary, then ask, when, if ever, will there no longer be a need for a federal role? In addition, ask, would we enact it the same way if we were starting over today? Has it been subject to a comprehensive review, reassessment and re-prioritization by a qualified and independent entity? If so, when? Have there been significant changes since then? If so, is another review called for?
- How does it measure success? Are the measures reasonable and consistent with the applicable statutory purpose? Are the measures outcome-based, and are all applicable costs and benefits being considered? If not, what is being done to do so?
- If there are outcome-based measures, how successful is it based on these measures?
- Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

# Illustrative Generic Re-examination Questions

- Is it affordable and financially sustainable over the longer term, given known cost trends and future fiscal imbalances?
- Is it using the most cost effective or net beneficial approaches when compared to other tools and program designs?
- If it fares well after considering all of these questions, is the responsible entity employing prevailing best practices to discharging its responsibilities and achieving its mission (e.g., strategic planning, organizational alignment, human capital strategy, financial management, technology management, acquisitions/sourcing strategy, change management, knowledge management, client/customer service)?
- What would be the likely consequences of eliminating the program, policy, function or activity? What would be the likely implications if its total funding was cut by 25%?



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